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Understanding the 4 Essential Nonprofit Financial Statements

Financial statements might just seem like numbers in spreadsheets or complex nonprofit accounting data, but the information that goes into these documents is what makes it possible for your nonprofit to thrive. They consist of donations, supplies, and grants that enable you to keep changing the world for the better!

These statements are essential because after starting your nonprofit, you will need some of the information for ongoing financial compliance. Some states require these statements while filing your nonprofit's taxes, most likely in the Form 990, so be sure to check your local requirements.

We are here to help you better understand the financial statements your organization should be keeping.

In this article we will go over:

- Balance Sheet
- Income Statement
- Statement of Cash Flows
- Statement of Functional Expenses

Let's dive in!

First, download our template of these statements so you can follow along. We collaborated with a group of expert nonprofit treasurers to ensure this template is ready for your nonprofit to use!

Balance Sheet

Let's start with the nonprofit accounting basics: the balance sheet. For tax-exempt organizations, the balance sheet is also known as the **statement of financial position**. This statement shows what your company owns and what it owes at a specific date.

Think of it as a picture of your financial situation at one point in time. The IRS does ask for this information when you are registering your organization, as well as when filling out your 990, so it is best to have it updated before beginning on your yearly tax journey.

If you remember one thing from your accounting 101 class it will be the balance sheet equation: assets = liabilities + owner's equity. This is the traditional equation that for-profit businesses will use to create their balance sheet.

As a nonprofit organization, you do not have owner's equity because you are not a publicly-traded company, so this equation is going to change a little bit.

For a nonprofit balance sheet, you will use the equation: **assets = liabilities + net assets** (instead of owner's equity). Let's break this down into simpler terms.

Note that our template shows the Statement of Financial Position with assets on the left, and liabilities and net assets on the right. Generally, these will all be listed one after the other, but we recommend that you start out viewing it from left to right so you can understand the balance sheet equation.

Pro tip: If you are in the early stages of creating your nonprofit, you may be thinking, can a nonprofit really make money? The answer is yes! Nonprofits can have many assets including profit from their programs, sales, or services.

Assets

We will start with the left side of the equation, assets. **Assets are what your nonprofit owns**. You will find things like furniture, supplies (office supplies, event supplies, or any equipment needed for programs), and money (cash, donations, and grants) under assets.

Assets are listed in order of liquidity, or their ability to be converted into cash. For example, you would list cash first, and after it could be gift cards, grants receivable (any grants you have been given but not yet cashed), and lastly things like property and equipment. See our example below:

Assets	Current Year	Previous Year
Current Assets		
Cash and cash equivalents		
Grants receiveable		
Accounts receivable		
Contributions Receivable		
Short term investments		
Total Current Assets	0.00	0.00
Long Term Assets		
Land		
Building		
Equipment		
Contributions Receivable		
Long term investments		
Total Long Term Assets	0.00	0.00

If your nonprofit organization owns a building, land, or vehicle, these would all be listed under assets. You could also see intangible assets, which are assets that are not physical. This includes copyrights, trademarks, or patents that your nonprofit owns.

Liabilities

Now moving to the right side of the balance sheet equation, we have liabilities. If assets are what your organization owns, **liabilities are what it owes**. Liabilities include things like accounts payable (what you need to pay out, like to a website design consultant), debt (loans), and grants payable (if you give grants to other organizations).

Liabilities are listed in order of the length of obligation, or when you need to pay them. A typical balance sheet will break these down into current vs. long-term liabilities to make it easier to differentiate between.

Things like accounts payable will go under current liabilities because this is what you owe in the near future, or within one year. For example, the bill for champagne for a fundraising gala would go in accounts payable. Long-term liabilities usually include things like car loans and mortgages, because these payments will last over several years.

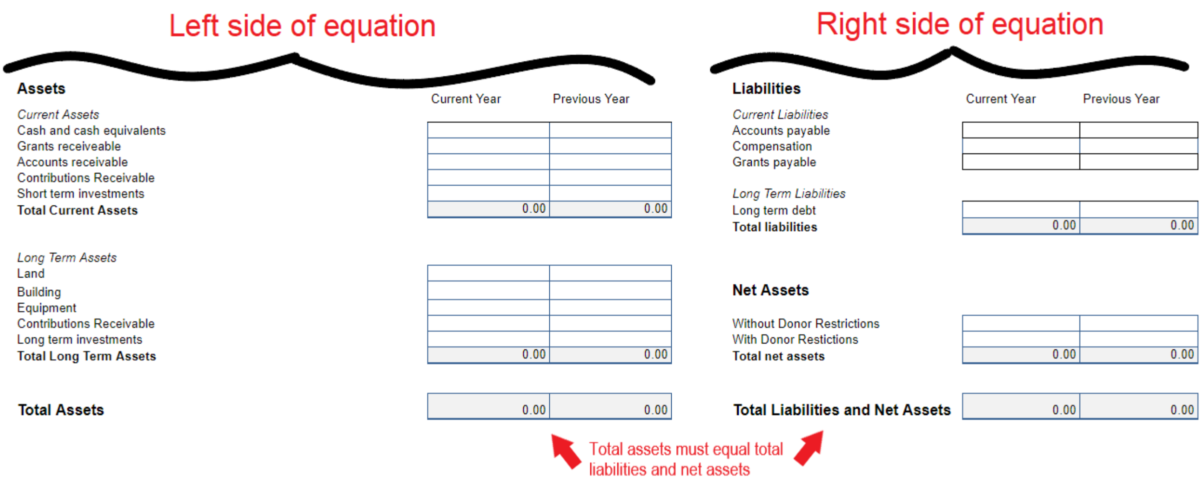
Liabilities

	Current Year	Previous Year
Current Liabilities		
Accounts payable		
Compensation		
Grants payable		
Long Term Liabilities		
Long term debt		
Total liabilities	0.00	0.00

Net Assets

To understand what net assets are, you first need to understand that **the left and right sides of the balance sheet equation must equal**, or balance (see what they did there). That said, net assets are any assets left over after liabilities are taken out.

Let us explain. So we already have numbers on the left side of the balance sheet from your assets like cash and grants, but so far on the right side, we have only listed what you owe (liabilities). Now we need to add back the remaining amount so that the left and right sides of the equation will balance.



The net assets section is essentially residual assets from current and previous years of operations. So what exactly can be included in net assets? Anything that holds value. For example, cash, investments, fixed assets, prepaid expenses, and accounts receivable all hold value.

The important thing to note with net assets is that all of these items aren't listed line by line. Net assets considers where this item is coming from, and how it is being used by breaking the assets down into with and without donor restrictions.

Sometimes the assets you hold have restrictions on them, like not to be used until a certain date, or should be dedicated to a specific purpose. Any asset that you receive with a restriction like this should be categorized as donor restrictions, otherwise, it can be included without donor restrictions.

For example, when we talked about assets we mentioned cash, but where is this cash coming from? It could be from things like donor contributions. You will look at these donations even further to determine which ones have restrictions and which ones do not.

So what about assets such as property and equipment? These are generally not restricted unless donated for a specific purpose, such as a building to be used to house beneficiaries. If they are unrestricted they should be compiled into the without donor restrictions category.

Pro Tip: You can see on the template that with and without donor restrictions are grouped altogether, without breaking down the exact assets. If you want to better understand where these numbers are coming from, you can list each asset separately under the category. For example, if you collect membership dues, these can be listed under without restrictions, membership dues.

Congratulations, you have made it through your first financial statement! This one is one of the most challenging, so the rest will come smoothly.

Income Statement

Chances are you have heard of an income statement before because they are vital to for-profit companies. An income statement is also known as a **statement of activities** for nonprofit organizations. As the name suggests, it will show all of the financial activity of your organization and the financial result of your work.

Unlike the balance sheet, which is a picture at a single point in time, an income statement is like a video, showing what happens over a period of time (your accounting year). The basic equation used for this statement is **revenues - expenses = change in net assets**. Essentially, funds coming in - the cost of operating nonprofit = funds available to continue operations.

Your revenues and expenses should be broken down to show what the revenue or expense was, such as fundraising income, grants, and program expenses. Just like the net assets from the balance sheet, these will be categorized with and without donor restrictions.

Revenue	Without Donor Restrictions	With Donor Restrictions	Total
Contributions			0.00
Membership dues			0.00
Grants			0.00
Fundraising events			0.00
Net assets released form restrictions			0.00
Total revenues	0.00	0.00	0.00

If there is something you are not sure how to classify, be sure to check GAAP or IFRS. These are accounting standards for U.S. and international financial reporting, respectively. GAAP are specific rules that are widely used in the U.S. and each state has different regulations on compliance, particularly regarding accounting for donations. Make sure you and your accountant are in compliance with your state regulations on GAAP!

Keep in mind that a nonprofit organization's income statement is different from a for-profit, and the biggest difference is the use of gross receipts.

Usually, in an income statement, you will see gross sales, or the revenue from sales before costs or taxes are taken out. For a nonprofit, **gross receipts** replace gross sales. Gross receipts are the amount of money your nonprofit has raised without any expenses being taken out. It sounds very similar to gross sales, but there is one big difference. Gross sales only include sales of products or services but leave out non-sales services like donations. This obviously would not work for a nonprofit organization, and so you use gross receipts because it includes all of your income.

Pro Tip: There are two ways to record revenue and expenses, the cash method and the accrual method. The accrual method is the most widely used and is the standard for GAAP. In this case, revenue should be recorded during the period it is earned. For example: if you have an event in January but collect the ticket fees in December, the revenue should be recorded in January when the event is held.

Statement of Cash Flows

The statement of cash flows tracks cash going in and out of your organization. Think of it as an **X-ray of your cash flows**. The statement of cash flows is helpful to your organization because it will provide explanations for the revenue and expenses that you recorded in the previous statements.

This statement is divided into operating, investing, and financing activities:

- **Operating activities** are the revenues and expenses from operating your nonprofit. For example, the cost to pay salaries, revenue from contributions, and purchase of office supplies.

Cash flows from Operating Activities	Current Year	Previous Year
Cash received from contributions		
Proceeds on sale of equipment		
Cash paid to employees		
Purchase of office supplies		
Net cash from operating activities	0.00	0.00

- **Investing activities** would include things like interest earned on investments, purchase of long-term investments, and payments on long-term investments like buildings, land, or equipment.

Cash flows from Investing Activities		
Proceeds from maturity of long term investments		
Purchase of long-term investments		
Purchase of property and eqipment		
Net cash from operating activities	0.00	0.00

- **Financing activities** are earnings and expenses from financial activities such as interest earned from savings, or interest paid on loans.

Cash flows from Financing Activities		
Collection of contributions rstricted for long term purposes		
Payment of long term debt		
Net cash from financing activities	0.00	0.00

This breakdown allows you to see where your nonprofit has extra cash, and where you are using too much cash.

Pro Tip: Cash inflows and outflows are also known as sources and uses of cash, respectively.

Statement of Functional Expenses

If you have never heard of this financial statement before it is because it is exclusive to nonprofit organizations. The IRS also asks for some of the information in this statement when you file your 990.

The statement of functional expenses **shows expenses of each functional area of the organization** such as programs, fundraising, and management. You will see that the expenses listed in this statement are broken down further to list exact expenses. Some examples include salaries, events, and administrative costs.

	Program Services		Supporting Services		
	Program A	Program B	Management and General	Fundraising	Total
Compensation					
Full-time salaries					0.00
Part-time salaries					0.00
Employee benefits					0.00
Total compensation	0.00	0.00	0.00	0.00	0.00
Program related expense 1					0.00
Program related expense 2					0.00
Program related expense 3					0.00
Office Supplies					0.00

The statement of functional expenses is beneficial to nonprofit organizations because a lot of donors like to see **how expenses are being distributed**. Also, certifications such as those provided by Charity Navigator and Guidestar use this information to rate your organization.

That is it, you made it! Those are the 4 essential nonprofit financial statements. We hope this article helped you to better understand these documents so that you can know the financial situation of your nonprofit.

If you are preparing these financial statements, you should check the IRS's compliance guide for public charities, private foundations, or tax-exempt organizations other than 501(c)(3) public charities and private foundations for detailed information about what to include in these documents.